

creating an expectation of retirement in violation of a key definitional requirement of CET1. It makes little sense to impose what is, in effect, a 10-year “no-call” provision on an instrument that can be left outstanding indefinitely with no adverse legal or economic consequences whatsoever to the issuer.

*Required Amendment to Capitalization Bylaws.* The Proposed Rule establishes a default rule that all forms and types of allocated surplus (revolving, non-revolving, qualified, nonqualified) would no longer count in regulatory capital (i.e., Tier 1 or Tier 2 capital), even if the issuer prominently disclosed to members at the time of issuance that they would generally not receive this capital until liquidation. This default rule is subject to an exception. Under the exception, allocated surplus is elevated up to CET1 status (or Tier 2 status) if, and only if, the issuer obtains stockholder approval of a capitalization bylaw that tells the members that they will not and cannot receive a retirement of such allocated surplus within 10 years of the issuance date (or 5 years in case of Tier 2 capital).

As an issuer of nonqualified allocated surplus that is not subject to any type of retirement program and, indeed, has never been retired, Farm Credit West strenuously objects to a default rule that would remove this capital entirely from both Tier 1 and Tier 2 regulatory capital. Holders of our allocated surplus have no rights to distributions (short of an actual liquidation) because our Bylaws give the Board complete unfettered discretion to retain the capital indefinitely. I do not see how a bylaw amendment that limits our ability to make redemptions is necessary or appropriate when holders do not possess distribution rights in the first place. To our knowledge, no Farm Credit System institution or non-System cooperative has ever placed an explicit minimum term on its allocated equities.

Also, I believe our stockholders would be somewhat mystified receiving a ballot asking them to restrict the Board’s discretion on the timing of allocated surplus retirements when I have already told our members not to expect any retirements of allocated surplus. I anticipate that many of our members would criticize the vote as a waste of money.

Moreover, the proposal could back-fire, creating pressure on the Board to begin retiring allocated surplus, at least at the 10-year mark. Then there is the possibility that stockholders reject the proposal, resulting in a complete exclusion of our nonqualified notices from regulatory capital, notwithstanding that the notices themselves currently state that “Farm Credit West, ACA’s Board of Directors considers this surplus to be permanently invested in the Association. As such, there is no current plan to revolve or redeem these amounts.”

*Treatment of Member Held Stock.* I believe that all purchased stock in a System institution held by a member should count as Tier 2 capital, to the extent it does not count as Tier 1 capital, provided the stock lacks an explicit term or maturity. Under the Basel III criteria for Tier 1 and Tier 2 capital, I cannot envision a capital instrument that is characterized as equity under GAAP and that lacks an explicit maturity as falling completely outside of the definitions of Tier 1 and 2 capital. Member-held stock that is purchased as a condition of obtaining a loan or as part of an “H” stock program is fully at risk. Because such stock lacks an explicit maturity, it is redeemable solely at the Board’s discretion and constitutes equity under GAAP. The Farm Credit Act recognizes member-held stock as regulatory capital through the statutory permanent